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The new Keynesian trade-off between output and inflation: Time series based evidence from Russia

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Abstract: As oil exports remain the main source of income for the Russian economy, the ongoing plunging of global oil prices is causing severe adverse supply shock and cost-push inflation in the country. The recent attempts at stabilisation policies by the policymakers have not been very successful in stabilising both national output and inflation. This has brought about concern over the relevance of policymaker interventions in the Russian economy. We investigate this matter by applying Asai's (1999) model. Our empirical results indicated that the trade-off between output and inflation in the short run in Russia is inversely associated with the mean rate of inflation, which supports the new Keynesian view. As such, stabilisation policies, particularly monetary policies adopted by policymakers, are extremely crucial in moderating the short-run trade-off between output and inflation with respect to the recent financial crisis.

JEL Classifications: E31, E61, C22

Keywords: Output-inflation trade-off, new Keynesian, new classical, nominal rigidity
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1. Introduction

The severe balance of payment shock since the fourth quarter of 2014 has caused the Russian economy to enter a major financial crisis. The crisis is partly attributable to monetary policy normalisation and geopolitical tensions followed by economic sanctions, which caused capital outflow from the country, but the primary cause is attributable to the declining global oil price (Sinyakov & Yudaeva, 2016). The Russian economy is a resource-dependent economy in which the growth of the economy is largely dependent on global oil prices. Thus, plummeting global oil prices have exposed the Russian economy to severe external shocks.

The abovementioned events in Russia following the global oil price drop have been documented (see for example, Idrisov, Ponomarev, & Sinelnikov-Murylev, 2016; Ilyashenko & Kuklina, 2017). The reduction in oil export duties has led to the depreciation of the ruble and worsening of the terms of trade of the Russian economy, which has resulted in cost-push inflation and adverse supply shocks in the country. The recent studies of Ivanova (2016) and Bhattarai (2016) have provided evidence towards the existence of cost-push inflation in the Russian economy in the current crisis. The former